United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

76-5026

United States Court of Appeals
FOR THE SECOND CIRCUIT

B

Docket No. 76-5026

P/S

In Re
Banque de Financement, S.A.,
Debtor.

Banque de Financement, S.A.,
Appellant,

First National Bank of Boston,
and
Chase Manhattan Bank, N.A.,
Appellees,

Firestone Tire and Rubber Company,
Intervenor in Support of Appellant.

On Appeal from the United States District Court
For the Southern District of New York

REPLY BRIEF OF APPELLANT BANQUE DE FINANCEMENT, S.A.

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REPLY BRIEF OF APPELLANT BANQUE DE FINANCEMENT, S.A.

Preliminary Statement

Appellant Banque de Financement, S.A. ("Finabank") submits this brief in reply to the briefs of Appellees, First National Bank of Boston ("FNBB") and The Chase Manhattan Bank, N.A. ("Chase").

ARGUMENT

I

A Bankruptcy Court Has No Power To Discriminate Among General Creditors

The most striking omission from FNBB's brief is any discussion of the real issues on this appeal—that is, when, if ever, can a bankruptcy court discriminate in favor of one group of general creditors to the prejudice of another group of general creditors? And, can it do so when the express purpose for so doing is to favor "Americans" over "foreigners"?

The answer, quite simply, is that a bankruptcy court can never engage in calculated economic discrimination.

To better place in perspective the arguments advanced by FNBB, it is useful to first consider the standard by which this Court must judge this appeal. FNBB argues at great length that the "clearly erroneous" standard found in Bankruptcy Rule 810 applies, thus limiting the scope of this Court's review. FNBB is wrong on this point, for two reasons.

First, this appeal turns on questions of law, not questions of fact. The principal question is whether this Court's holding in *Israel-British Bank (London) Ltd.* v. *FDIC,* 536 F.2d 509 (2d Cir.), *cert. denied,* Nos. 76-271 & 272 (U.S. Nov. 28, 1976), that foreign banking institutions with assets in the United States may utilize the provisions of the Bankruptcy Act, is to be emasculated by a doctrine which favors "local" creditors over general creditors as a whole. A subsidiary question is whether a Chapter XI case can be dismissed outright (assuming that the debtor was incapable of rehabilitation from the outset), without converting the

case to Chapter VII, when the result of dismissal is to favor two creditors (FNBB and Chase) to the exclusion of all others.* A further question, along the same line, is whether the drastic sanction of dismissal of a Chapter XI case can be employed without conducting a hearing to determine whether less drastic measures would better protect the general creditors and the debtor's estate. These are questions of law; they are not answered by findings of fact.

Second, Bankruptcy Rule 810 operates exactly as does Rule 52(a) of the Federal Rules of Civil Procedure. Such a rule has no application when there has been no hearing in which witnesses were heard and their credibility weighed. *Orvis* v. *Higgins*, 180 F.2d 537, 538 (2d Cir.), *cert. denied*, 340 U.S. 810 (1950); *accord, e.g.*, 5A J. MOORE, MOORE'S FEDERAL PRACTICE ¶ 52.04, at 2688 (1975); *United States ex rel. Gonzalez* v. *Zelker*, 477 F.2d 797 (2d Cir.) *cert. denied*, 414 U.S. 924 (1973); 13 COLLIER ON BANKRUPTCY ¶810.05 (1976). There was no hearing in this case.

From the erroneous premise that the decisions below are esssentially unreviewable, FNBB then urges that there was "ample legal authority to dismiss." It then sets forth five "grounds" for the dismissal. On review, those five "grounds" become only two—(1) Finabank's alleged inability to be rehabilitated and (2) the problem of creditor notice as it relates to Finabank's customer-depositors.

Neither of these "grounds" gives rise to "authority" to dismiss.

---

* In the unlikely event that assets are left after Chase and FNBB are paid, those assets will go to a German Bank, Investions-und-Handels-Bank AG., which, like FNBB and Chase, obtained an order of attachment (but belatedly so) against Finabank for $4,380,937.54. *Investions-und-Handels-Bank AG.* v. *Banque de Financement, S.A.* (Sup. Ct. N.Y. Co.) (now pending).

Consider first the "rehabilitation" issue. FNBB makes much of the fact that "Finabank could have, but did not, request any evidentiary hearing, and Judge Ward found that no evidentiary hearing 'was required since the underlying facts were undisputed.'" (FNBB Brief at 8.) In truth, Finabank did request an evidentiary hearing; that request was denied through silence by the court.

At the oral argument on FNBB's motion to dismiss, the following colloquy took place:

> Mr. Marrin: We would like our day in court to show this petition was filed in good faith.
>
> The Court: I hope you are not putting your reputation on putting through an XI.
>
> Mr. Marrin: I am talking about what happened on May 5th when it was filed. Your Honor can switch us over to a liquidation and that would go back to the original petition.
>
> The Court: There is no doubt if I have jurisdiction I would adjudicate you at some stage of the proceeding simply because there is twelve million dollars here.
>
> Why should I bother; why do I want to be such a nasty person to the American banks?
>
> Mr. Marrin: I think you do have to protect the creditors in general. (A 186-87)

Clearly, Finabank asked for a chance to prove to the court facts that would have supported its position that rehabilitation was contemplated on May 5, 1975, when the Chapter XI petition was filed. But, on this point, Finabank was denied its day in court.

But, let us assume (without conceding, because it is not true) that there was never any prospect for rehabilitation, that Finabank knew this at the outset, and that it filed a Chapter XI petition anyway. Even if this were the case, which it is not, dismissal would not have been permissible.

If unsecured creditors would be prejudiced by a dismissal (as they would here because of the FNBB and Chase attachments), adjudication is required and dismissal is prohibited. *In re Chambertin, Inc.*, No. B74-1984A (N.D. Ga. 1975), *reported at* 6 COLLIER BANKRUPTCY CASES 75 (1976).

In fact, as bankruptcy authorities have long recognized,

> [t]here is no requirement that a Chapter XI petition be filed in good faith. Legislation to amend Chapter XI so as to require a finding that the petition was filed in good faith was proposed in 1940 (H.R. 9864, 76th Cong., 3d Sess.) but failed of enactment. ADMIN. OFFICE OF U. S. CTS., PROCEEDINGS OF FOURTH SEMINAR FOR REFEREES IN BANKRUPTCY 364 (1967).

And as the Hon. Asa S. Herzog has noted:

> One of the problems frequently encountered in a Chapter XI is when and under what conditions the Court may terminate the proceedings by adjudication or dismissal. Some referees seem to think that they can adjudicate or dismiss at will—whenever they are dissatisfied with the way things are going—or whenever the conduct of the debtor seems to justify such action.
>
> This is not so. . . . ADMIN. OFFICE OF THE U. S. CTS., PROCEEDINGS OF THE SECOND SEMINAR FOR REFEREES IN BANKRUPTCY 405 (1965).

Case law consistently confirms that Bankruptcy Judge Herzog was right; the test to be applied throughout a Chapter XI case is what action will best benefit the general creditors as a whole and the debtor. The test is *not* whether the bankruptcy court disapproves of the debtor's conduct.

The case of *Ira Haupt & Co.* v. *Klebanow*, 348 F.2d 907 (2d Cir. 1965), which is the principal authority relied upon

by both FNBB and the courts below, for example, actually confirms Finabank's position. In *Ira Haupt,* this Court allowed a dismissal of a Chapter XI because "ordinary bankruptcy [was] the appropriate vehicle" and the Chapter XI was filed in a pending Chapter VII bankruptcy. *Id.* at 908. Dismissal of the Chapter XI simply meant that the pre-existing Chapter VII continued. *Id.* In Finabank's case, dismissal of its Chapter XI petition without an adjudication has the opposite effect. No bankruptcy proceeding is left pending, the attachments are left standing, and a new Chapter VII filing cannot reach the attached assets. The general creditors lose everything to two huge banks.

In *In re Bush Terminal Co.,* 84 F.2d 984 (2d Cir. 1936), this Court reversed a dismissal of a reorganization proceeding, dismissal having resulted when a bankruptcy court concluded rehabilitation was not possible. The instructions given by this Court on remand were that if no plan of reorganization were adopted "then to dispose of the property of the debtor, or the proceeds thereof, in such way as will adequately protect all creditors, either by liquidation in bankruptcy or by reorganization in the equity suit, or, in the event that the claims of creditors are satisfied, by turning over the property to the defendant after dismissing all proceedings on proper terms." *Id.* at 986. In other words, this Court directed that dismissal was not permitted if dismissal resulted in a compromise of the position of the general creditors as a whole.

The leading treatise on bankruptcy confirms the correctness of that approach.

> [In reaching a decision on whether to dismiss, adjudicate, or direct that the case proceed] the Court must weigh the interests of both the debtor and creditors and determine which course of action would be best for both. *In the ordinary case,*

> *the interest of both the debtor and his creditors will require that the court adjudge the debtor a bankrupt and direct that bankruptcy be proceeded with pursuant to the Act.* Thus, the financial affairs of the debtor may be in such condition that the administration of his estate in bankruptcy is necessary to prevent attachments, preferences, dissipation of assets, and other events injurious to the interest of creditors in general. 9 COLLIER ON BANKRUPTCY ¶ 10.04 [2], at 524-25 (1976) (emphasis added).

Only in rare cases is dismissal permissible. Such cases are those where state law assignment for the benefit of creditors proceedings are nearly complete or the debtor has acquired substantial property after filing his petition, which property will be placed beyond the reach of creditors as a result of a bankruptcy. *Id.* Dismissal is also appropriate if *all* of a debtor's assets have been validly seized and their seizure is not voidable. *In re May Lee Industries, Inc.*, No. 74B166 (S.D.N.Y. 1975), *reported at* 6 COLLIER BANKRUPTCY CASES 366 (1976). Those situations, however, are not this case.

The issue of creditor notice*—the impact of Swiss law on any attempt by Finabank to publicly disclose the *names* of its depositors—likewise is no basis for dismissal. It would be a very peculiar rule of law indeed that would allow one creditor to take all of a company's U.S. assets because that creditor claimed it could not assure itself that all of the other creditors would receive notice of the pendency of the bankruptcy proceeding. It is also hard to believe that a

*The purposes of listing creditors are to allow the court to notify them, to inform the court of their claims, and to prevent the debtor from discharging a debt owed to a party who is not told of the proceedings. *See* 1A COLLIER ON BANKRUPTCY ¶ 7.11[2], at 990 (1976). If a creditor is actually informed of the proceedings, the failure to list him is of no consequence. *Id.* ¶ 7.08 [2], at 985.

creditor has solicitude for the rights of others when the result of its proposition turns out to be that the solicitous creditor (the two banks) gets everythnig and those who are to be protected by getting notice get nothing.

Here, this Court has assurance that the Swiss authorities will mail out notice (in the form approved by the bankruptcy court) to all of Finabank's creditors. In fact, this procedure has already been used by Judge Werker in the interpleader case. Unless one assumes that officials of the Swiss court are totally unreliable, it is difficult to understand why this procedure would be inadequate in a bankruptcy context. *See, e.g.,* 1A COLLIER ON BANKRUPTCY ¶17.23[5] (1976) (explaining the many types of notice that courts have found acceptable).

II

The So-Called Rehabilitation Admissions— A Diversion

Having studiously avoided the real issue on this appeal, the FNBB brief, in an extreme attempt at "coloration," devotes a substantial part of its presentation to a purported dissection of statements made by counsel for Finabank before the Bankruptcy Judge. (FNBB Brief at 7-13.) Not only are these supposedly damnable admissions taken out of context, but far from being evil or insidious, they are merely forthright discussions with the court on the difficult financial condition of the debtor; they are neither more, nor less. But beyond that, damnable or forthright, counsel's statements are totally irrelevant to the issue on this appeal.

Finabank's counsel is quoted for having advised the court that a rehabilitation was unlikely. At the same sessions, however, counsel also advised the court as follows:

> Mr. Marrin: Well, basically all the funds in New York are tied up by the attachment for an interpleader action. In Switzerland they are all under a semi-government, semi-court, supervision.
>
> There is one chance that the company stands to recover fifty million dollars to sixty million dollars of funds which would give fresh life if they could. The court has just ruled now—it was on a TRO—but, a fair reading of it does show that Banque de Financement has a right to this money. (A 117)*

and

> Mr. Marrin: . . . . As I think I have advised you before, there might be a consent to an adjudication, in any event.
>
> I am waiting from Switzerland for word on whether there is a—
>
> The Court: Once he makes a motion to dismiss on subject matter jurisdiction, I don't have to adjudicate. (A119)

and

> The Court: . . . . and factually so you and I both know, Mr. Marrin, you will not propose an arrangement, you can't propose an arrangement.
>
> Mr. Marrin: That is not true. . . . (A 180)

and

> The Court: There is no doubt if I have jurisdiction I would adjudicate you at some stage of the proceeding simply because there is twelve million dollars here.

---

* This suit is an action in the Bahamas between Finabank, Edilcentro International, Ltd. (referred to in our principal brief as a bank, but more properly denominated a financial institution) and Edilcentro's parent, Societe Generale Immobiliare.

> Why should I bother; why do I want to be such a nasty person to the American banks?
>
> Mr. Marrin: I think you do have to protect the creditors in general. (A 187)

There are no contradictions. The court was being informed of a situation that is characteristic of most Chapter XI's—they are difficult to analyze and accomplish; success in them absolutely defies prediction. Despite these uncertainties, arrangements under Chapter XI are often worthwhile causes to pursue. If successful, they are invariably more beneficial to both creditors and the debtor than liquidation. And if not successful, or if at any stage the court concludes that further effort does not appear propitious, the solution is simple and conventional—adjudication and transfer to Chapter VII. This is what should have been done here.

Counsel' statements, made in the context of the normal give and take between judge and attorney, reflect a candid, realistic approach to a difficult problem. More importantly, they do not merit further analysis because they have no bearing on how this case should be determined. Rehabilitation is not an issue. Finabank should have been adjudicated a bankrupt, and *at every stage* stood ready to accept this, if the court became convinced that rehabilitation was unlikely.

What should not have occurred was a dismissal of the Chapter XI proceeding for the sole purpose of favoring two huge banks over other general creditors, just because the favored appeared to be "American" and the disfavored, "foreigners." This is the raw legal question raised on this appeal, nothing else.

Conclusion

For the foregoing reasons, and those previously stated, the order appealed from should be reversed and the case remanded to the Bankruptcy Judge with instructions to adjudicate Finabank a bankrupt.

Dated: New York, New York
December 6, 1976

Respectfully submitted,

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AFFIDAVIT

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On Appeal from the United States District Court
For the Southern District of New York

State of New York)
County of New York) ss.:

Thomas C. Reycraft, being duly sworn, deposes and says:

I am over the age of twenty-one years and reside at 668 Ely Avenue, Pelham, in the County of Westchester, State of New York. On the 6th day of December at 4:30 p.m., I served three (3) copies of the REPLY BRIEF OF APPELLANT BANQUE DE FINANCEMENT, S.A. by messenger who deposited copies of same at the offices of the following parties:

Breed Abbott & Morgan
One Chase Manhattan Plaza
New York, N. Y.
Attorneys for First National Bank of Boston

Cleary Gottlieb Steen & Hamilton
One State Street Plaza
New York, N. Y.
Attorneys for Firestone Tire and Rubber Company

Milbank Tweed Hadley & McCloy
One Chase Manhattan Plaza
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Attorneys for Chase Manhattan Bank

Thomas C. Reycraft

Thomas C. Reycraft

Sworn to before me this
6th day of December 1976

Michael J. Hoops

MICHAEL J. HOOPS
Notary Public, State of New York
No. 30-4503056
Qualified in Nassau County
Commission Expires March 30, 1977